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PROGRAMME BUDGET FOR THE BIENNIUM 1996-1997

REPORT OF THE SECRETARY-GENERAL ON THE ACTIVITIES OF THE OFFICE OF INTERNAL OVERSIGHT SERVICES

Note by the Secretary-General

1. Pursuant to General Assembly resolutions 50/214 of 23 December 1995 and 48/218 B of 29 July 1994, the Secretary-General has the honour to transmit, for the attention of the General Assembly, the annexed report, conveyed to him by the Under-Secretary-General for Internal Oversight Services, on the review of outsourcing practices at the United Nations.

2. The Secretary-General notes that measures have been taken or initiated to correct many of the issues addressed in the review and concurs with the recommendations contained in the report.

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ANNEX

Report of the Office of Internal Oversight Services on the review of outsourcing practices at the United Nations

SUMMARY

The United Nations has been outsourcing a number of services in order to provide support for its day-to-day operations. The Office of Internal Oversight Services undertook a comprehensive audit of outsourcing practices at the United Nations, which consisted of several audits conducted at several duty stations and missions and covered a wide range of services.

Outsourcing, if managed properly, can be a viable means for achieving efficiency, effectiveness and cost reduction, in addition to providing the expertise the United Nations requires to supplement its personnel. This could also allow programme managers to concentrate on substantive activities and better perform the Organization's core functions. However, our audits indicated a need for policy guidelines on outsourcing and for improvements in the contract award and contract administration processes.

The audits reviewed the following aspects of outsourcing practices: (a) effectiveness of overall outsourcing to date; (b) contracting process of outsourced services and adequacy of its internal controls; (c) monitoring of contractors' performance by management to ensure that service delivery complied with contract terms; and (d) management's process of decision-making and analytical support. The Office recommends policy and/or procedural changes to enhance the efficiency of future outsourcing efforts.

Our major findings and recommendations are:

(a) There is no Organization-wide policy on outsourcing. The lack of policy guidelines has contributed to the inconsistent outsourcing approaches by programme managers. There is a need to develop Organization-wide policy guidelines for the effective management of outsourcing;

(b) Outsourcing should accomplish one or more goals, ranging from acquiring technical expertise, cost savings, efficiency and expediting a process to providing temporary assistance. The Office found, however, that few programme managers were able to identify the extent of goals achieved;

(c) Successful outsourcing of services depends greatly upon proficient management of the procurement process. The Office has disclosed a number of cases of non-compliance with procurement procedures. It has also identified a number of weaknesses in the Request for Proposal process, including inadequate maintenance of contract documentation and limited market research and competition;

(d) The Office's audits disclosed that, for the majority of outsourcing contracts reviewed, programme managers did not formally evaluate the vendors' performance. In fact, programme managers rely heavily on vendors to provide information with minimal verification. The lack of proper monitoring of vendors' performance seems to be a major weakness in outsourcing practices in the United Nations. Thus, there is a great need to ensure monitoring of vendor performance;

(e) Outsourcing can be a positive innovation while having an impact upon staff prospects for employment and career development. The Office therefore recommends the establishment of a focal point within the Department of Administration and Management who would be responsible for: identifying potential areas for outsourcing, providing methodological support for cost-benefit analyses, developing criteria and initiating market testing of selected activities to determine whether they should be performed by outside providers.

The review concluded that the Organization should give serious consideration to expanding the use of outsourcing where justified by a cost-benefit analysis. In order to achieve intended gains in efficiency and effectiveness, however, it is crucial to ensure vigilant monitoring/evaluation of the outsourcing exercise.

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I. INTRODUCTION

1. In its resolution 50/214 of 23 December 1995, the General Assembly requested the Office of Internal Oversight Services "to undertake a comprehensive audit of the outsourcing practices, including, in particular, the contracting process, and to report thereon to the General Assembly at its fifty-first session" (part III, para. 55).

2. For the purpose of the present review outsourcing has been defined as "the provision by third parties of non-core services and activities which used to be, are or could be provided by the United Nations". The United Nations has outsourced a variety of support services, including catering operations, travel, computer installation and maintenance, software applications development and support, building maintenance and cleaning.

3. At the Secretariat, the Procurement and Transportation Division of the Office of Conference and Support Services has overall responsibility for the Organization's procurement/contracting process and therefore plays a large role in the outsourcing efforts of the United Nations. Individual programme managers also play a crucial role in technical evaluation and the contract administration part of outsourcing exercises.

4. At Headquarters, as part of the same office, Conference Services and Support Services (including the Buildings Management Service and Electronic Services Division) are principal users of outsourcing as a means of providing a variety of services to the Organization. Outsourcing services contracted for at offices away from Headquarters or in the field are usually administered locally.

II. OBJECTIVES

5. The main objectives of the audits were:

- To evaluate the effectiveness of outsourcing to date and recommend policy and/or procedural changes to enhance future outsourcing efforts;

- To review the process employed in contracting outsourced services to assess the adequacy of internal controls;

- To determine whether contractor performance was adequately monitored to ensure that service delivery complied with contract terms;

- To review management's outsourcing decision-making and analytical support processes to determine if each outsourcing decision was based on a thorough review of the current service requirements and an examination of all possible options for service provision.

III. SCOPE

6. The audits reviewed a broad array of outsourcing-related contracts and services provided since 1990 by the Secretariat in New York, by the United Nations offices at Geneva (UNOG), Nairobi (UNON) and Vienna (UNOV), the Office of the United Nations High Commissioner for Refugees (UNHCR), the International Trade Centre (ITC), as well as by peacekeeping missions in the former Yugoslavia (United Nations Peace Forces (UNPF)), Haiti (United Nations Mission in Haiti (UNMIH)) and Angola (United Nations Angola Verification Mission III (UNAVEM III)). The outsourced services reviewed are diverse, and include translation, catering, garage administration, telecommunications, cleaning, office automation, printing and publication, logistical support, transportation, and storage and distribution of publications (see appendix). Whereas some of these services, such as cleaning and maintenance, had been outsourced from the outset of the United Nations, others, such as garage administration, had been performed by the United Nations staff until very recently.

7. A number of contracts reviewed (although not a scientific sample in terms of either total volume or total dollar value) provide a comprehensive view of the Organization's outsourcing activities. The Office audited directly more than 25 contracts and agreements valued at more than $100 million. The review also took into consideration previous audits which contained recommendations of service areas which may be candidates for future outsourcing efforts. The scope of the review was coordinated with the Joint Inspection Unit.

IV. METHODOLOGY

8. The review was performed with a view to highlighting major issues and concerns of a policy nature. The methodology included structured interviews with the responsible officers, review of relevant documents and, where possible, benchmarking to industry standards. Financial and administrative control issues identified during the review were communicated directly to the individual programme managers for corrective action, and have not been included in the present report. The current literature in the fields of procurement/contracting and outsourcing was consulted to validate the approach to outsourcing reported herein.

9. The draft of this report was provided to the Office of Conference and Support Services for comments. Their responses have been incorporated in the final report, where appropriate.

V. MAJOR FINDINGS AND RECOMMENDATIONS

10. Outsourcing, if managed properly, can be a viable means for achieving efficiency and effectiveness, in addition to providing the expertise that the United Nations requires so as to supplement its personnel. This could also allow programme managers to concentrate on substantive activities and better perform the Organization's core functions. However, the Office's audits indicated that there is a need for policy guidelines on outsourcing and for improvements in the contract award and contract administration processes. The

sections below focus on those findings and recommendations that were common to most of the audited areas and have general application for the successful implementation of the outsourcing process. They should facilitate a greater understanding of the strengths and weaknesses in the current outsourcing process and provide a blueprint for future action.

A. Need for Organization-wide policy on outsourcing

11. In initiating this review, the Office sought to determine if any policy had been established prescribing either method or manner in which outsourcing of services was to occur. It was not possible to locate any such policy, and therefore it was necessary to establish the criteria against which to measure the outsourcing performance. The Office believes that the lack of policy guidelines has contributed to inconsistent outsourcing approaches taken by programme managers throughout the Organization. This has had a critical impact both on costs and the quality of services provided, in that contract terms are not always advantageous to the United Nations. For a majority of the outsourced services reviewed, programme managers lacked either technical or contracting expertise, and needed guidance on best practices in structuring and administering contracts.

> Recommendation 1. The Office recommends that, prior to any expansion of outsourcing activities, the Department of Administration and Management formulate and articulate the policy objectives and develop guidelines for the effective management of the outsourcing process. (AM96/224/001)

12. The policy statement should include a working definition of "outsourcing" and be explicit in prescribing both standards of service and financial objectives. The guidelines should include the following:

- Criteria for determining when a service becomes a candidate for outsourcing;
- Quantitative and qualitative analyses prerequisite to the decision-making process;
- Processes to be followed in specifying the Organization's requirements and developing the bid document;
- Contract administration requirements, including monitoring of vendor performance, and contract evaluation;
- Standard clauses to be included in every contract.

The Office believes that establishment of these policy guidelines would better assure the success of the outsourcing initiative.

B. Definition of "outsourcing"

13. As mentioned above, there is no standard operational definition for "outsourcing" within the United Nations. As the appendix indicates, outsourcing practices at the United Nations take different forms, ranging from service or personnel contracts and purchase orders to the use of Special Service Agreements (SSAs). As a result, a review was carried out of numerous "outsourced" services and their contracts which, although initially identified as outsourcing, were in fact management's efforts to supplement departmental personnel resources.

14. The Office ascertained that the majority of departments included in the review did not conduct cost-benefit analyses and/or market research prior to letting their service contracts, and therefore had no objective method of determining whether the use of service contracts was the most efficient and cost-effective method to achieve the desired results.

15. The Office found that, for such services as office automation support, translation and cleaning, programme managers continued to assume responsibility for the actual provision of the services, with contractors' staff furnishing assistance. In effect, the contractors' staff functioned as United Nations staff without the contractor assuming any liability for contractual performance. In these cases, the contractor provides staff rather than services.

16. If the Organization's ability to deliver service is hampered by a lack of personnel, this should be clearly identified as the problem. This will enable the Organization to determine the optimal strategy for providing these services, whether it be through outsourcing the service, allocating funding for additional staff or hiring consultants on a temporary basis. In the current situation, however, outsourcing is too often employed as a "reactive" management strategy to supplement limited personnel resources.

C. Achievement of outsourcing goals

17. When an organization decides to outsource non-core services, it generally aims to accomplish one or more of the following:

- Acquire technical expertise not available within the Organization;
- Achieve cost savings;
- Expedite a process or processes;
- Provide service more efficiently;
- Provide a service not needed on a long-term basis.

In order to assess the success of the outsourcing effort, the Office first sought to determine what its impetus was. Management's decision-making process was reviewed to identify which of the above considerations led the managers to pursue their outsourcing strategy.

18. With the exception of garage administration and translation services, which conducted thorough cost-benefit analyses, the programme managers did not articulate their reasons prior to making the decision to outsource certain services and activities. In the absence of this critical information, it was impossible to establish the extent to which the stated objectives had been achieved.

19. Indeed, at the conclusion of each contract, with no benchmarks against which to measure success, management has been unable to judge whether the outsourcing exercise was effective and should be continued, or was deficient, requiring consideration of alternative strategies. The Office found that the expected economies had been achieved for garage administration. With regard to translation services at Headquarters, greater economies could have been realized if more outsourcing had been implemented.

20. An attempt was made to evaluate the outsourced activities by applying cost-effectiveness as the principal benchmark, but it was impossible to establish that most of the outsourced activities had achieved this objective. Firstly, as most of the audits pointed out, the United Nations accounting system is not activity-based and therefore it is not easy to associate costs with corresponding activities. Secondly, most of the operations would need significant improvement in their management control systems to facilitate analysis or to achieve the desired result. However, it was possible to establish that, in some cases, outsourcing was more costly than providing in-house services. At UNMIH in Haiti, for example, after the camp maintenance and laundry services had been taken in-house, substantial cost savings were immediately realized; monthly costs were reduced by 66.5 per cent from $157,288 to $52,870.

21. Some services, such as office automation support and contractual translation, are provided by individuals through Special Service Agreements. In the Electronic Services Division, Special Service Agreements have proved to be a more economical means to provide personnel than service contracts. Despite the rapid expansion of the Organization's use of, and its dependence on, computer technology, the Division was not given sufficient posts to respond to the new requirements. Its decision to convert outsourcing contracts to SSAs was the strategy employed to overcome its problem of understaffing. When the office automation support service contract was expiring, the Division conducted a cost comparison between the use of service contracts and Special Service Agreements, which indicated that Special Service Agreements could provide savings to the Organization.

22. However, owing to the limited duration (normally six months within a given year) of Special Service Agreements, exceptions had to be made for the Division to ensure the provision of services over an extended period of time.

> Recommendation 2. Given that the Organization will continue to need to hire technical expertise in the areas of rapidly changing technology, the Office recommends that the Department of Administration and Management explore other alternatives to Special Service Agreement arrangements to facilitate a longer-term solution. (AM96/224/002)

23. The Office noted that, for contractual translation, Headquarters relies on service contracts awarded to agencies (after competitive bidding) for some languages (Chinese and Russian) and Special Service Agreements for the others (Arabic, English, French and Spanish). Similarly, UNOV uses agencies for some languages (Chinese, Spanish and Russian) and Special Service Agreements for the others. While both approaches were equally effective, there was little communication between the offices on the effectiveness of either strategy.

Recommendation 3. For the future, the Office recommends that offices using the same or similar outsourced services share their mutual experiences and knowledge. The recommended focal point on outsourcing (see recommendation 13) should promote this process. (AM96/224/003)

D. Strengthening the pre-bid process

24. Successful outsourcing of services depends greatly upon proficient management of the procurement process. There are two major phases in the procurement process. The first is the pre-bid, which encompasses specification development, market research and advertising or identifying the vendor base. The second phase relates to the conduct of the bid process itself. Issues pertaining to the bid process will be addressed separately in section II.E.

1. Need for comprehensive bid documents and tight contractual requirements

25. The review identified a number of areas within the pre-bid process which could be improved. Development of good, clear, detailed bid specifications, based on reasonable estimates of levels of service to be provided, are critical to the formulation of a solid bid document. The quality of the proposals submitted by vendors will depend, in part, on the quality of the bid document issued by the United Nations. The Office discovered instances where inaccurate estimates or unclear description of services required resulted in contract terms disadvantageous and, at times, more costly to the United Nations.

(a) Specifying requirements

26. In the case of Headquarters cleaning services/elevator operators contract, estimates of certain large-value cost elements were not included in the original contract. In addition, during the contract term there were numerous changes to service requirements and salary rates (hiring of additional staff, salary increments, etc.) which were not formalized as amendments to the contract. As a result of the above situation and inadequate monitoring of expenditures on the part of the United Nations, the contractor was paid $4 million in excess of the contract's original estimated value as approved by the Headquarters Committee on Contracts. These unforeseen expenses, though properly documented and verified, had a negative impact on the accuracy of the budget estimates. The contract also did not include a penalty or compensation clause concerning the obligation of the vendor to deliver cleaning supplies at the lowest prices.

27. In its response to the draft report, the Procurement and Transportation Division stated that, as a result of the Organization's experience in this area, the new bidding exercise conducted earlier in the year has attempted to address those issues.

28. In the case of the Headquarters office automation support services contract, the original Request for Proposal did not define the Electronic Services Division's staffing requirements and used a benchmark of 18, which proved to be unrealistic. Six months after the contract had become effective, the service level had increased to 24. Subsequently, it more than tripled to over 60. Even though there were certain factors which the Division could not have anticipated, such as the explosion of the LAN, the Office believes that if the Division had developed a more thorough scope of its service requirements, the unit cost could have been reduced. Indeed, given the expanded scope that emerged, additional vendors may have been induced to respond to the Request for Proposal.

29. The United Nations awarded a catering contract at Headquarters whereby the Organization subsidized the operation by financing building space, utilities, maintenance, etc. The contract did not stipulate any profit-sharing between the contractor and the United Nations, resulting in the contractor retaining the entire profit generated during the contract term. The rationale for this catering concession and contractual arrangement was to offer lower food prices to the United Nations employees. However, this expectation was not clearly stipulated in the contract and the anticipated benefit not required to be verified by the contract managers.

30. In its response to the draft report, the Buildings and Commercial Services Division stated that the Request for Proposal for the management and operation of the catering facilities at the United Nations Headquarters, New York, which is now being finalized, seeks to recover any and all costs incurred by the Organization in outsourcing this contract. At the same time, it provides a possibility for a revenue-sharing element as a percentage of gross sales.

31. In the case of the staff transportation services provided at UNON, the vendor that was awarded the contract, as the lowest bidder, increased its prices only two months after signing the contract and requested higher monthly rates resulting in increased costs of almost 46 per cent. Yet the contract was renewed each year despite this experience.

(b) Penalty clauses

32. In most of the contracts and services reviewed, the Office's auditors pointed to the need for inclusion of penalty clauses. For example, in the provision of telecommunication services for UNMIH, the company failed to deliver the services on time and provided lower-grade circuits than specified. The contract did not prescribe penalties for late performance and substandard service, which, it was established, had a negative impact on operations.

33. Most of the contracts do not provide penalties for contractor malperformance or non-performance. In those cases, the only remedy is to cancel and rebid the contract. The expense and time required to rebid the contract as

a means of responding to minor infractions by the contractor is likely to be non-productive. The contract should provide managers with enough latitude to ensure that contract terms are met. Penalty clauses will enable managers to assess fines against a vendor for non-compliance in specified areas without necessitating contract cancellation.

Recommendation 4. The Office recommends that procurement services ensure that contracts for outsourcing include penalty clauses. (AM96/224/004)

(c) Contract price

34. An area needing improvement and guidelines is the specification of the contract price. The Organization initially awarded contracts mostly on a cost-plus basis. However, recent experience has demonstrated the advantages of a fixed-price contract so long as the scope of service is well defined and service delivery is controllable. Benefits to the Organization include the ability to improve the planning and control processes and reduced contract administration requirements. The Office found that the contracting process for the cost-plus Headquarters cleaning services contract was often extensively delayed owing to numerous amendments and specification adjustments which were time-consuming, labour-intensive and, finally, costly.

(d) Errors in completing the contract

35. There is a need to tighten the contracting process at completion. The Office found two cases in which companies came into existence after the contracts had been awarded, and although not the awardees of the contracts, or even related companies, they were allowed to sign as the contracting party. These cases relate to the contractors for provision of storage and distribution of publications at UNON, and for the provision of international contractual personnel at UNPF.

2. Need for training in developing contract Specifications

36. Part of the reason for poor bid specification development can be attributed to the fact that certain of these services had never been outsourced and programme managers did not have sufficient expertise in this area. If the Organization is to continue and/or expand its outsourcing efforts, managers' skills in this area have to be strengthened.

Recommendation 5. The Office recommends the provision of training to relevant personnel in developing contract specifications. (AM96/224/005)

3. Market research and benchmarking

37. Market research is another element that assures successful development of a bid document. Information regarding the number and type of entities that provide a specific service as well as knowledge of standard industry rates and practices would enhance the quality of the bid document. Benchmarking of costs,

productivity and other criteria can provide requisitioners and procurement personnel with realistic expectations regarding market opportunities.

38. The Office's audits indicated that often contracts were bid with minimal market research and no data on industry benchmarks gathered to support the bid process. The telecommunications and the cleaning and maintenance contracts typified this approach.

4. Increase in access to technical and professional databases

39. One reason for contract managers' failure to perform market research may be their lack of expertise in this technique. Another possible explanation is minimal access to substantial sources of information. There are numerous international databases, technical publications, professional associations and the Internet, all of which can be accessed by the procurement professional in order to obtain vendor and product information. Implementation of this option should become standard, not only in the procurement of outsourced services, but also in all procurement activities.

> Recommendation 6. The Office recommends that technical capability of procurement services should be enhanced through access to technical and professional databases. (AM96/224/006)

5. Expanded role for procurement services to include technical support/advice

40. Since procurement services have the main responsibility for the contracting process, they should perform market research and provide technical support in the form of consultative advice to the programme areas during the pre-bid phase of the process.

6. Increased emphasis on contract planning

41. Another issue which arose in many of the cases examined centred on planning. Inadequate planning was exhibited by the Buildings Management Service and the Electronic Services Division in their implementation of the outsourcing process. This is evidenced by the number of backdated contracts and amendments included in our sample. Contractors began service provision prior to the official completion of paperwork. Conversely, in other cases, such as cleaning and garage administration, contractors continued to provide service long after the contract expiration date.

42. By allowing contractors without a valid contract to provide services, contract managers foster an environment which can increase the Organization's liability. More importantly, however, lack of planning on the part of the contract manager can create a situation where there is insufficient time to complete the bid process. This, in turn, can have a negative impact on the operations or delay the delivery of services, as was demonstrated in the provision of telecommunication services and installation of equipment at UNMIH.

The United Nations negotiated the rations contract two months after the planned transition, and the service contract four months after the transition from the Multinational Force to a United Nations operation. In the meantime, services continued to be provided under a Letter of Assist. The delays cost the Organization $11.4 million because costs were higher under the Letter of Assist than under the contracts. Emphasis should be placed on incorporating sufficient lead time into the contract process, which should result not only in a reduction in the percentage of expired contracts but, more importantly, enable the contract manager to maintain control over the contracting process.

7. Development of an automated system to facilitate contract planning

43. The REALITY system is not currently being used as a contract management system. The Organization should consider automating its contracting process. One key feature of any off-the-shelf system selected should be a planning module which would allow the programme manager to build in "flags". These flags would notify the programme manager that a contract is due to expire, providing sufficient lead time to enable a solid procurement process. The time-frame associated with each flag would vary depending on the size and complexity of the project. This would also eliminate, or at least reduce, the need for retroactive contracts.

> Recommendation 7. The Office recommends that the Organization consider automating its contracting process, including a planning module to highlight contracts close to expiration. (AM96/224/007)

44. The Procurement and Transportation Division responded that such a system was already in use in the Division. To date this system had been maintained under a separate data processing system. The Division indicated that it was currently reviewing means of maintaining information more centrally.

45. The Office encourages this initiative and recommends that, until the database is accessible to all programme managers, the Division continue to assume responsibility for notifying programme areas of impending contract expirations.

8. Discouraging the use of sole source contracts

46. A number of contracts included in the present review were let without any bidding taking place. We strongly encourage the Headquarters Committee on Contracts/Local Committee on Contracts to enforce the policy of rejecting contracts which are submitted for approval and have not been bid on a competitive basis, except for the cases under financial rule 110.19. The contracts for the garage administration ($66,841) and for the conference attendants programme ($360,000) were awarded without giving vendors the opportunity to bid.

47. Competing bids provide the contract manager with a basis for comparison, opportunities to leverage negotiation strategies and the ability to create a

database of qualified vendors as a reference for future bid processes. Absence of bidding also leads to the appearance, if not the fact, of impropriety.

48. The same applies to the need for rebidding. Among the contracts reviewed, in a number of cases such as the three catering operations at Headquarters, UNOG and ITC, contracts were renewed without rebidding for as long as 10 years.

> Recommendation 8. The Organization should enforce a policy which requires programme managers who request contracts for approval that have not been subject to the bid process to justify the need for a sole source contract. (AM96/224/008)

Accepted justifications generally relate to specialized expertise unique to the vendor which is needed by the Organization or the urgent need to provide services on an emergency basis.

49. While many of the above recommendations relate to both standard procurement and the outsourcing process, the Office believes that, given the increased trend towards outsourcing, implementation of guidelines based on these recommendations should be made a priority for future outsourcing activities.

E. Need for improving the contracting process

50. Many of the contracts included in the present review were bid using a Request for Proposal methodology. There are many benefits to this contracting method, primarily, the ability to select a vendor based on criteria other than costs. Use of the Request for Proposal process is also a preferred bid method when contracting for new services where it is difficult to define the specifications comprehensively. Since for a number of programme managers this was a first attempt at contracting out a service, the Request for Proposal approach was an apt choice.

51. However, based on the cumulative data provided by this outsourcing experience, the Office believes there are a number of improvements which can be incorporated into the Request for Proposal mechanism to facilitate better management of the contracting process.

1. Development of standardized request for proposal guidelines

52. There appeared to be no standard guidelines for the conduct of the Request for Proposal process itself. Certain programme managers developed vendor bid lists, created evaluation teams and advertised the bid opportunity. Others either awarded sole source contracts, consistently renewed with the same vendor or sent the bid document to a pre-selected list of vendors. Often there was no written procedure describing how the evaluation of the vendor proposals was to be conducted. As a result, evaluation and selection processes varied widely from contract to contract.

Recommendation 9. The Office recommends that procurement services develop standardized Request for Proposal guidelines for programme managers to follow. (AM96/224/009)

The Office was informed by the Office of Conference and Support Services that this will be addressed in the new Policy and Procurement Manual.

2. Maintenance of contract documentation

53. Departments rarely could provide documentation (including vendor proposals) to support the decision of the technical evaluation team. Therefore, an analysis of the selection process by the auditors was not possible.

54. The Office was assured that in each case the selection was fair and equitable, based on a thorough and rigorous review of the proposals. However, in the absence of substantiating documents, it is not possible to support these statements.

55. Since the outsourced services often represent a significant allocation of financial resources, the Office believes that both procurement services and the programme managers have an obligation to ensure that, to the extent possible, the contract process is flawless in both planning and execution. To not achieve this result can have far-reaching consequences for the Organization. To promote improvement of the outsourcing effort the Office offers the following suggestions:

3. Expanded advertising efforts

56. Advertising solicitations to as wide an audience as possible should provide assurance of maximum competition from qualified service providers, resulting in better prices and/or terms and conditions. The current practice of sending the proposals to a shortlist of vendors without advertising limits competition and precludes potential vendors from submitting bids. Although certain programme managers interviewed expressed concern that they would be overwhelmed with responses, the Office does not share this concern, for the simple reason that few contractors possess large-scale operations sufficient to meet the needs of an organization as large as the United Nations. Based on vendor expressions of interest, Requests for Proposals could then be sent to qualified vendors. In addition, the Organization should continue its efforts to solicit suggestions from Member States in order to build a credible, qualified vendor database.

57. For example, the previous cleaning contracts at Headquarters required a minimum of 145 on-site staff at any given time. Most contractors are not equipped to handle that volume. However, having made that observation, the Office does believe that more than one contractor in the New York metropolitan region is capable of bidding on this contract. Yet the same vendor has been awarded the contract for over 40 years. It is contrary to sound procurement policy to maintain such a long-term sole source relationship, unless the

contractor is either providing expertise that does not exist elsewhere or there is a "partnering" approach whereby the contractor provides special pre-negotiated concessions in return for an exclusive contract. The Office did not find either of the above-described conditions to be true in the case of the United Nations cleaning contract. Expanded advertising efforts could promote competition in areas that have consistently awarded the contract to the same vendor, e.g., cleaning services, elevator operations, garage administration, United Nations Bookshop and Headquarters Gift Shop, as well as conference and coat services.

4. Use of the Internet as a marketing tool

58. The Office encourages the Organization seriously to consider advertising bid opportunities on the Internet. The United Nations can utilize its Web page to notify potential vendors of upcoming contract solicitations. The Office believes the benefits of this medium far outweigh any negatives and that it merits implementation on a trial basis. The Internet-based advertising process would enable non-local vendors to bid, which could promote competition, resulting in reduced costs and improved quality of responses. The dollar value of the contract would determine whether it is in a non-local vendor's interest to provide services to the duty station concerned. If the response is indeed overwhelming, this option can be re-evaluated and fine-tuned to include only contracts valued at a minimum dollar threshold.

5. Development of Request for Proposal evaluation criteria and process

59. To standardize and improve the evaluation process, the Office recommends a number of actions. First, the Procurement and Transportation Division should incorporate evaluation criteria into the Request for Proposals. This is an important control measure which ensures the integrity of the process by preventing technical evaluators from changing the criteria in the middle of the selection process in order to benefit a "preferred" vendor/proposal.

6. Standardization of the evaluation process

60. We additionally suggest that the Procurement and Transportation Division develop guidelines outlining how the evaluation process should be conducted, whether through discussions, interviews, completion of rating sheets or a combination of all three. Finally, regardless of the evaluation method used, the results of the proposal evaluation and subsequent vendor selection must be documented and the documentation retained in the contract file.

7. Need for negotiations to be performed exclusively by the Procurement and Transportation Division

61. We found that a number of programme managers were negotiating contract amendments with the vendors. This practice weakens internal controls.

> Recommendation 10. Since only the procurement services have the function of negotiating contracts on behalf of the United Nations, the Office recommends that the users (i.e., programme managers) of outsourced services discontinue their current practice of negotiating contract amendments regarding cost elements and other terms and conditions. (AM96/224/009)

8. Considering the use of professional negotiation expertise

62. For large-value contracts which require specialized technical expertise, the Procurement and Transportation Division could examine the possibility of using outside expertise to negotiate with the selected vendor. Professional negotiators are often able to reduce the contract price by a few percentage points. Since their fee is a percentage of the decreased amount, the cost for this service will be more than offset by the benefits/savings achieved. Similarly, for services which have not previously been contracted out, an independent assessment of requirements by a consultant possessing expertise in the particular service area could substantially improve the bid document.

63. In its response, the Procurement and Transportation Division expressed concern that the use of a third party to conduct commercial negotiations on the Organization's part would create a confidentiality risk situation. In the absence of specifics it is difficult for the auditors to comment on the plausibility of this concern. Suffice it to say that the Office believes the idea merits further consideration, taking into account United Nations rules of confidentiality.

F. Ensuring contract monitoring

1. Introducing the concept of contract management

64. If outsourcing continues to be considered a viable cost-reduction strategy, the Organization must place much greater emphasis on contract monitoring. Often, the rationale for outsourcing - reduced costs - is offset by the reality of the contracting process. In other words, if proper care is not taken to ensure that bid prices do not exceed original estimates, change orders and amendments do not exceed budgets and anticipated revenues are not "lost" to poorly designed contractual arrangements, the outsourcing effort will result in greater expense to the Organization than in-house staff services incurred.

65. In the cases the Office reviewed, the single, glaring deficiency was the tendency on the part of the programme managers to rely heavily on the vendors to provide information regarding: level of effort required by the contract, quality and units of service provided, preparation of billing and invoicing. The Office acknowledges the fact that often the vendors have specialized

expertise. They should determine optimal resource allocation and submit documentation to substantiate invoices.

66. However, the Office was concerned by the lack of independent verification by the United Nations programme managers. Audits disclosed a number of cases which could have been prevented with proper contract management and evaluation. These included: non-compliance with contractual arrangements, overtime payment, overpayment, erroneous financial reporting, frequent contract amendments and increased prices and salaries. Surprise inspections of cleaning personnel, which would have confirmed the reliability of attendance data provided by the cleaning contractor's supervisors, were rarely conducted, if at all. Telecommunications staff could not provide us with their own inventory charts for equipment.

Recommendation 11. The Office recommends that the Organization address the issue of contract monitoring and provide more guidance to programme managers on contract management techniques before expanding its outsourcing efforts. (AM96/224/010)

2. Conduct of formal vendor evaluations

67. The Office's audit disclosed that, for the majority of outsourcing contracts reviewed, programme managers did not formally evaluate the vendors' performance. Contractors who do not perform well should be formally evaluated and the evaluation maintained in procurement services for reference in future decision-making. Conversely, evaluations for vendors who met or exceeded contract terms should be made available for consideration in future contract opportunities. Without such a database and sharing of information, vendors will continue to be awarded contracts with the Organization irrespective of their performance and will also not receive recognition for their achievements.

Recommendation 12. The Office recommends that the Organization establish measures to ensure that programme managers formally evaluate vendors upon completion of provision of service. (AM96/224/011)

G. Identifying new outsourcing opportunities

68. Given that outsourcing entails replacing the United Nations staff as service providers by outside contractors, either institutional or individual, it could inevitably have a negative impact on staff's prospects for employment and career development. Programme managers are responsible for managing their human resources, on the one hand, and for reducing costs and increasing efficiency, on the other. While outsourcing could result in bringing new technical expertise which could not be found in-house, managers could be placed in a difficult position in addressing outsourcing decisions.

69. The Office's audits have identified certain services as candidates for outsourcing, for example, the United Nations Postal Administration's marketing and sales, as well as the bookshop operations. Implementation of such outsourcing options would require further review as to how and which functions

should be outsourced. As pointed out in paragraphs 11 and 12, more formal procedures would be needed to ensure effective outsourcing practices at the United Nations. A focal point could play a key role in this regard.

70. During the Office's audits, several managers pointed out that more outside expertise should be sought in performing core functions. Especially in areas where specialized knowledge is required, such an approach could give programme managers more flexibility than the use of in-house expertise. In view of expected benefits, some of the managers showed an interest in using part of the resources currently budgeted for regular posts for engaging the services of consultants on an as-needed basis, even if this implied an overall reduction of their resources. Since its audits focused on non-core functions, the Office did not explore the possibility of expanding the use of outside expertise for core functions. The Office suggests, however, that the Organization, in identifying future opportunities for outsourcing, should extend its review beyond non-core and support services to established core functions and activities.

> Recommendation 13. The Office recommends the establishment of a focal point within the Department of Administration and Management who would be responsible for identifying potential areas for outsourcing, providing methodological support for cost/benefit analyses, developing criteria and initiating "market testing" of selected activities to determine whether they should be performed by outside providers. (AM96/224/012)

71. At this time of post reduction and budget downsizing, the Organization is obliged to seek different strategies to achieve efficiency and effectiveness. Outsourcing could be one strategy to provide programme managers, not only with improved operational efficiency and cost reductions, but also with new expertise and working methods. These opportunities should also be seized to grant programme managers some flexibility to supplement their personnel resources and expertise. Apart from this, outsourcing would also allow the departments and offices of the Organization to concentrate on substantive activities and better perform their core functions rather than being deeply involved in the provision of support services which are available elsewhere.

72. In conclusion, the Office wishes to emphasize that even if its recommendations are adopted and incorporated in a new outsourcing process, proof of the success of outsourcing will be obtained only through vigilant monitoring/evaluation of each outsourcing exercise. As with every other operational initiative, its success depends on the willingness of programme managers to perform in accordance with policy guidelines.

APPENDIX

List of outsourced contracts and services reviewed

Services provided	User departments/ offices	Types of contracts/ arrangements	Period reviewed	Amount of contract for the period covered	Remarks
Cleaning services	BMS, OCSS, Headquarters	Service contract (cost-plus)	March 1990-June 1996	$41 474 700	• Initially, the contract was until January 1992, but was kept amended for extension. • The same vendor had business with the Organization over 40 years.
	UNHCR	Service contract	May 1995-April 1996	$465 000	
	UNON	Service contract	April 1994-June 1996	$250 000	
	UNPF (Zagreb and Pleso)	Service contract (lump sum/fixed price)	April-June 1996	$57 584	
Catering services	CAS, OCSS, Headquarters	Service contract (profit and loss contract)	March 1986-February 1992; March 1991-March 1996 (Contract reviewed without bidding)		• Total gross sales of this period was $88 million. • Overhead to be charged to the United Nations (5% of the charge: facilities, equipment and utilities).

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Services provided	User departments/ offices	Types of contracts/ arrangements	Period reviewed	Amount of contract for the period covered	Remarks
Catering services (continued)	UNOG	Service contract (50/50 profit distribution; and 3.5% of sales revenues or management fee)	January 1992-December 1996 (The same vendor since 1976; bidding took place in 1991)	-	• Annual average sales SwF 8.2 million ($6.87 million). • The vendor pays a fixed fee for the use of the installation, equipment and salary of liaison officer. • For the use of electricity, water and 50% of materials, the vendor reimburses UNOG.
	ITC	Service contract (profit distribution, 2%)	January 1991-December 1997 (since 1976; renewed in 1986, 1988, 1990 and 1992 without rebidding)	-	• Annual average sales SwF 450,000 (= $375,000). • Since 1989, ITC covers the expenses for facilities, materials, rent and utilities, since no profit has been made.
	UNPF (Zagreb and Pleso)	Service contract (lump sum)	September 1995-January 1996	$1 259 366	• This only concerns the provision of services.
EDP-related services (a) Installation and support of office automation equipment, software, network components and computer operations; (b) Maintenance of data-processing equipment; (c) Maintenance of office automation equipment	ESD, OCSS, Headquarters UNOV	Service contract (cost plus) Service contract	July 1990-May 1996 (b) January 1996-January 1997 (c) July 1996-June 1997	Over $7.8 million (July 1993-May 1996) (b) $40 738.56 (c) $171 325	• Since January 1996 under SSAs.

Services provided	User departments/ offices	Types of contracts/ arrangements	Period reviewed	Amount of contract for the period covered	Remarks
<u>Telecommunication</u>					
(a) Telephone maintenance;	(a) ESD, OCSS, Headquarters	Service contract	December 1991-December 1992	$3.5 million	
(b) Back-up, realink and moral and welfare communications	(b) UNMIH	Service contract	March 1995-March 1996	$1 per minute	
<u>Logistical and support service</u>					
(a) Fuel and water distribution, camp and equipment maintenance;	(a) UNMIH	Service contract	August 1995-August 1996	6.9 million	
(b) Laundry and ground transportation;	(b) UNMIH	Service contract	August 1995-August 1996	6.1 million	
(c) Logistical and support service;	(c) UNAVEM III	Service contract	February 1995-February 1996	$17 670 785	
(d) Staff transportation	(d) UNON	Service contract	April 1993-June 1996	$1 200 000	
<u>Contractual translation</u>	OCSS, Headquarters	SSAs (C/S); SSAs (A/E/F/S)	January 1995-December 1996	-	
	UNOV	Service contracts (C/S/R); SSAs (A/E/F)	January-December 1996	Annual average $150 000	
<u>Printing</u>	UNOG	Service contract	95 - 1st quarter, 1996	-	• Proposed programme budget for the Printing Section: $1 614 400.
<u>External publications</u>	UNHCR	Service contract	August 1994-February 1995; August 1995-May 1996	$191 125; $120 214	
<u>Storage/distribution of publications</u>	UNON	Service contract	January 1984-June 1996	$1 100 000	
<u>Garage administration</u>	BMS, OCSS, Headquarters	Purchase order	June 1994-February 1995; March 1995-February 1996	$63 424.00 $66 481.92	• Partial outsourcing. • Provision of parking lot administrators.